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JAPAN : The Yakuza Recession

It is well known that a bad-debt crisis is primarily responsible for keeping Japan in recession. Now, investigations reveal the astonishing role of organized crime in prolonging that crisis

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SOMETIME DURING Japan's annual cherry-blossom festival last April, one of Tokyo's top private economists held a meeting that would reverberate across the Pacific and trigger alarm bells at the highest levels in Washington. At his office in a glass skyscraper in central Tokyo, he spoke with a veteran investment banker and colleague who also happened to be friends with Paul O'Neill, the United States Treasury Secretary. The economist, an American, and the investment banker, also American, were discussing a matter long the subject of innuendo: Japanese organized crime-the yakuza-and its role in the bad-debt crisis that is primarily responsible for keeping Japan in recession.

The economist spoke with urgency because in the previous year a small cadre of former FBI agents and other U.S. lawmen had uncovered a pattern of collusion between the banks and corporations that dominate the Japanese economy and yakuza gangsters that might even make a Russian oligarch blush. What is more, the economist said, those links suggested that the yakuza, far from being just a motley band of pimps, drug pushers, gamblers and extortionists-with only a peripheral role in their nation's multibillion dollar banking crisis-were in fact one of the most significant obstacles to its resolution. After returning to the U.S., the investment banker wasted no time outlining to his friend O'Neill the details of what retired police chief Raisuke Miyawaki has dubbed the "yakuza recession."

Neither Miyawaki nor any other credible commentator suggests that deflation, policy blunders, political inertia and a whole range of other factors haven't contributed to Japan's decade-long stagnation. All the same, Miyawaki, a Tokyo University Law School graduate, former spokesman for Prime Minister Yasuhiro Nakasone and former head of the National Police Agency's organized crime division, estimates that up to 50% of the bad debts held by Japanese banks could be impossible to recover because they involve organized crime and corrupt politicians. "I watched this develop in front of my eyes before I retired" in the 1980s, he says. "The key issue today is that a substantial portion of the existing bad loans cannot be recovered solely by bankers because the original loans involved politicians, bankers and yakuza."

No less troublesome, former U.S. law-enforcement officials now working for U.S. financial institutions in Japan worry that the yakuza might try to parlay their grip on the world's second-largest economy into a global presence. Already, some former U.S. lawmen believe, the yakuza could have ploughed as much as $50 billion into U.S. financial markets alone.

Although many Japanese politicians, police officers and other government officials scoff politely at Miyawaki's assertions, the results of the investigations headed by the former U.S. lawmen-now working full time on due-diligence investigations for U.S. investment banks in Japan-make compelling reading.

Starting in the late 1990s, U.S. investors began aggressively buying assets from cash-strapped Japanese companies. To date, they have spent at least $15 billion on everything from golf courses, theme parks and property to car, chemical and

pharmaceutical companies and pachinko pinball-machine parlours. High-profile American deals in Japan include the giant Ford Motor Co.'s takeover of Mazda Motor Corp.

Banking-industry insiders say some U.S. investors took stakes in enterprises that turned out to have ties to the yakuza. Earlier this year, for instance, the Tokyo office of U.S. institutional investor Lonestar was besieged by Japanese right-wing extremists after it bought Eventail, a golf-course management company with ties to the yakuza. An employee in Tokyo for the U.S. fund declined to comment. However, a Tokyo-based property analyst familiar with the incident says the company is "pretty cavalier" in its approach to business risks in Japan. "Maybe they see a chance to make so much money, so fast, that they can return to the United States before they encounter really serious trouble," he says.

In stark contrast, blue-chip U.S. investment banks leery of hurting their reputations have taken the unusual step of supplementing the accountants who do much of their due-diligence investigations with former FBI agents and other U.S. law-enforcement officials. These days, some U.S. financial institutions examine three to four deals a week for possible yakuza involvement; all told, in the past two years alone, they have used electronic databases, private investigators and contacts in the Japanese police, government and underworld to conduct at least 600 such investigations.

Many of the former U.S. law-enforcement agents who headed those probes were familiar with the yakuza from their days of public service. But even so, what they uncovered left them intrigued, amused and in some cases shocked.

To begin with, they found yakuza active in literally every sector of the Japanese economy; not only in areas such as construction, entertainment and trucking that have long been suspected of heavy yakuza involvement, but in everything from chemicals to hospitals. "In many ways it's easier for yakuza to operate hospitals," says a former FBI agent who has overseen investigations into 300 Japanese companies on behalf of a major U.S. investment bank. "Nobody expects them to be in that kind of business."

At the same time, almost half of the deals that crossed the desks of the former U.S. agents featured significant yakuza involvement. That doesn't mean yakuza control one of every two Japanese companies. However, a former agent says, it indicates that nearly half the companies that hold the key to resolving Japan's bad-debt crisis-that is, nearly half of Japan's most heavily indebted enterprises-probably are working with, have strong ties to or are controlled outright by gangsters. Between them, the former agent estimates, these companies borrowed $300 billion-400 billion from Japanese banks and funnelled as much as half of it to yakuza mobsters-substantially complicating the resolution of Japan's banking malaise.

"It was that first chunk, which couldn't be addressed, that stuffed up the banking system," and caused a credit crunch, another former agent says. "This had a follow-on effect on other borrowers who were not mob-connected but couldn't get bank financing and ended up going bust."

Contrary to the former agents' initial expectations, it was the bankers who first approached the yakuza and got Japan into its lingering financial mess-and not the other way round. For the four decades following the end of World War II, Japanese bankers funnelled the nation's savings into industries considered crucial for Japan's economy to catch up with the West's. The bankers lent money at the behest of the Japanese bureaucrats in charge of government policy, without checking the financial health of their borrowers, and at below-market interest rates. The banks' loan margins were pitiful. But bureaucrats ensured they earned steady profits by shielding them from competition and letting them charge high fees for retail banking.

Suddenly, in the 1980s, the banks' biggest borrowers started to look elsewhere for money. By then, Toyota, Sony, Honda and

the like could borrow more cheaply in international capital markets than at home. Faced with a drop-off in business, Japanese banks began aggressively courting new borrowers. In particular, says Manabu Miyazaki, a best-selling author who has also run for national office and whose father was a gangster boss, the banks pushed money on mobsters to sustain the growth of their loan portfolios.

Of course, it wasn't a one-way street. Once word spread that banks would lend money even to criminals, underworld figures were quick to take advantage. To Japan's at least 78,000 yakuza, it was an opportunity to shift away from the illegal gambling, prostitution, drugs, street peddling and protection rackets that had been their mainstays for four centuries, and enter legitimate businesses. By the time the bankers started to wonder whether they'd ever get their money back from their shiny new customers, they had already extended them billions in loans and it was too late.

Often, the banks lent to kigyo shatei, or front companies for yakuza organizations. Earlier this year, one U.S. financial institution investigated a Japanese bank looking for a foreign partner. While the bank didn't have a reputation for involvement with the yakuza, investigators discovered it had advanced as much as 80% of its $1 billion in outstanding loans to companies that were either related to or fronts for the yakuza.

In some of the more memorable instances of banking malfeasance, however, Japanese financiers handed money directly to major underworld bosses. For nearly a decade until his death in 1991, Susumu Ishii, the head of the Inagawakai, Japan's third-largest crime syndicate, was widely considered the boss of bosses of the Japanese underworld. All the same, 12 companies, including affiliates of Nomura Securities and Nikko Securities, lent him at least ¥38.4 billion (about $300 million at the current exchange rate). All told, the former U.S. lawmen say, the yakuza may have pulled the biggest financial scam in history.

Where is all that money? Clearly, some of it ended up in supposedly mob-free sectors of Japan's economy such as hospitals and health care. But arguably the bulk was invested in stocks and property. Miyazaki, the writer and gangster boss's son, insists financial institutions related to securities companies pushed stocks and property on yakuza borrowers especially vigorously. In 1999 a government-funded study by the Housing Loan Administration Corp. found that of 116 construction-related loans it examined in detail, 42% involved organized crime. Typically, says Miyazaki, financiers persuaded yakuza to buy stocks and property at inflated prices by paying them commissions up front and promising to find buyers willing to buy the assets at even higher prices. "Normal people wouldn't get involved in such schemes, so the banks grew reliant on the yakuza," Miyazaki says. As long as prices continued to climb, everybody was happy. Lenders watched their asset bases and profits rise, while gangsters grew rich pocketing commissions and capital gains.

Then Japan's bubble burst. In the early 1990s, when it dawned on people that Japan was suffering unsustainable asset-price inflation, investors willing to chase prices even higher suddenly disappeared. Against expectations, scores of gangsters found themselves stuck with stocks and property plummeting in value by the day, and massive debts they were unable to repay. Some yakuza solved their dilemma in accordance with an old underworld maxim: okane wa nai, kubi wa nai; you have no money, you have no neck. "I have three relatives and friends who committed suicide because of bankers," Miyazaki says. Many more, though, simply refused to meet their debts or hand over the properties they had used as collateral.

When Japanese bankers started to push their recalcitrant new customers to follow the letter of their loan agreements they had no idea what to expect: After all, for years they had dealt almost solely with legitimate companies, many of them household names worldwide. It didn't take long for the bankers to figure things out. In 1993, a killer gunned down the vice-president in charge of collecting bad loans at Hanwa Bank in Wakayama Prefecture east of Osaka. The following year another professional assassin shot and killed the vice-president in charge of bad-debt collection at Sumitomo Bank in Nagoya.

In addition, since 1997, seven ranking Japanese officials investigating banking industry irregularities or about to testify

about Japan's bad-debt woes have died under mysterious circumstances. Most recently, in September 2000, Tadao Honma, a former director of the Bank of Japan, was found dead in a hotel room in Osaka. Two weeks earlier the 60-year-old had become president of Nippon Credit Bank, a bankrupt bank that had lent to Japanese gangsters. Although Honma had been examining some of those loans in the days before he died, and the hotel guest next door heard fighting in Honma's room, police judged his death a suicide by asphyxiation and did not conduct an autopsy.

In the wake of those killings and suspicious deaths, Japanese bankers greet advice to accelerate the clean-up of their bad debts by asking to whom they should turn for protection from organized crime. "The banks are still afraid of foreclosing on some companies because they are afraid of what the yakuza will do to them," says Robert Whiting, the author of Tokyo Underworld and an expert on Japanese organized crime. "On top of that there are a lot of LDP [the ruling Liberal Democratic Party] guys involved in this whole mess."

ALARMING CONFLICTS OF INTEREST

Perhaps more alarming than the scope of gangster activity in Japan is that widespread corruption and conflicts of interest among politicians, bureaucrats and the rest of the nation's ruling elite could prolong the resolution of Japan's bad-debt crisis for another decade. Many Japanese politicians are reluctant to address the yakuza's role in the bad-debt crisis because they rely on gangsters for help raising campaign funds and fending off intra-party rivals. "There's not a single Diet member who doesn't know his local yakuza boss," says the secretary to a senior member of Prime Minister Junichiro Koizumi's LDP.

In 1999, for instance, LDP power-broker Eichi Nakao was arrested for taking bribes from Wakachiku Construction in Tokyo in exchange for funnelling public-works contracts to the company. Under questioning, the former construction minister admitted to taking ¥20 million in cash and a check for ¥10 million. In many ways Nakao's arrest was unexceptional. Since the start of the "yakuza recession" quite literally scores of Japanese politicians have been embarrassed by allegations of or arrested for taking kickbacks, including 10 fingered last month for rigging public-works spending contracts in return for some ¥100 million in bribes. But what set Nakao's arrest apart is that the man who introduced him to Wakachiku was Heo Young-joong, a Korean-Japanese businessman who was also a leading figure in the 40,000-strong Yamaguchi Gumi, Japan's biggest organized crime syndicate. A former U.S. lawman who has investigated scores of Japanese companies describes the ties between politicians, big business and yakuza as "breathtaking."

The bureaucrats who draft and implement most Japanese laws and the police officers who enforce them face their own conflicts of interest. To begin with, bureaucrats are paid poorly compared with their peers in the private sector. More important, when a bureaucrat snags the top job in a Japanese ministry, his seniors and contemporaries must resign, symbolically handing over absolute power. For many bureaucrats that means looking for work in their early 50s. In the end, most join the companies and semi-governmental agencies they once oversaw, a practice known as amakudari, or descent from heaven. "Over time," notes Chalmers Johnson, an American political scientist, "the continued practice of amakudari contributed to serious corruption."

Likewise, on retirement Japan's poorly paid police officers often take jobs at the companies they once investigated. These officers frequently end up as security guards in yakuza-dominated businesses in various industries, such as construction and shipping. And because patrolmen know years in advance that they'll need such sinecures, the temptation to treat the yakuza with kid gloves has brought about dozens of bribery scandals over the past decade. Says a former FBI agent: "The goal of the police in Japan is to manage and control organized crime, not eradicate it." Japan's public prosecutors and judges have been caught or implicated in a web of corruption scandals as well.

Such shenanigans might sound like sweet fodder for aggressive young reporters. But not in Japan, where most of the mainstream journalists covering the bankers, politicians, bureaucrats and police officers who bear the greatest responsibility for the yakuza recession-and are also their nation's only hope of resolving it-are reluctant to criticize their sources within the

establishment. "The Japanese media, especially newspapers and television, studiously avoid reporting about the relationship between yakuza and the bad loans," says Miyawaki, the former lawman, "because they're just a mouthpiece for the establishment."

An award-winning journalist at a major Japanese newspaper estimates that when he covered the Japanese Treasury, he reported less than a 10th of what he knew, paying no attention in print to the horse-trading behind the allocation of the government's annual budget. Moreover, in August last year Takeshi Gomi, the president of the Kokkai Times, a daily that covers the Japanese parliament and politics, admitted to taking money from government officials. Twice a year for the past 20 years, Gomi said, he had pocketed between ¥500,000 and ¥2 million.

When Miyawaki first minted the moniker "yakuza recession" in 1992, he predicted it "would continue a long time into the future." While successive Japanese governments dismissed him as ill-informed, Japan's bad debts grew and its stagnation lingered. Today, Japan's bad debts are less a mountain than a Himalayan peak. The government has little to say on the issue that sounds convincing. But independent banking analysts estimate bad debts run to between $800 billion and twice that figure. Miyawaki thinks even the higher independent estimate might be too low. Either way, Japan's bad-debt fiasco dwarfs the $150 billion Savings and Loan crisis in the U.S. in the 1980s. In the Japanese fiscal year ending March 31, Japan's four biggest banking groups alone expect to lose ¥1.6 trillion. Amid rumours that a major banking crisis is imminent, starting last month officials in Tokyo began to openly discuss a second bailout in three years for the ailing banking industry. "We will not let an economic crisis occur in February or March," Taku Yamasaki, secretary-general of the LDP said in late December. "We will take emergency measures when necessary."

At the same time, earlier piecemeal attempts to kick-start its economy and rescue its banks have helped saddle Japan with a national debt of some ¥650 trillion, equivalent to 130% of its GDP, earning it the unwelcome sobriquet "the Italy of Asia." On December 4 Moody's Investors Service became the third international debt-rating agency to cut Japan's sovereign-debt rating in three weeks, leaving it ranked on a par with-no coincidence here-Italy.

The state of Japan's finances and more than 600 due-diligence investigations conducted by former U.S. law-enforcement officials on behalf of U.S. investment banks might seem to have vindicated Miyawaki's assessment of Japan's woes. Yet the meticulous, self-effacing former law-enforcement official takes little pleasure in this. Instead, he travels the world encouraging foreign investors schooled in the fundamentals of risk management to take charge of Japan's financial system. Foreigners, Miyawaki said in a lecture at the Japan Society in New York in November, should "buy the big, stupid Japanese banks that lent large sums to the yakuza during the bubble era, because as you can see the executives running them today don't have the ability to restore Japan's banks to soundness."

Others, by contrast, worry about what the yakuza's role in Japan's banking fiasco might mean for the rest of the world. The U.S. government, in its latest International Crime Threat Assessment, described the yakuza as one of "the world's largest and most powerful criminal syndicates," and singled out the Inagawakai for laundering money in the United States.

The former U.S. lawmen see good reason to worry. "I think the yakuza have enough invested in the U.S. market that if they took it out it would really cause a problem," says a former FBI agent. "The yakuza have their own investment bankers and accountants and lawyers that they have sponsored, educated and use. They know how to keep a low profile and generate profits in a tough economy. The yakuza are suffering from the recession as much as anyone and are looking for alternative sources of income all the time. The financial markets offer more and more options that will make them more of a global problem if we are not careful."

THE YAKUZA

The elaborately tattooed yakuza date to the 16th century, when unemployed samurai formed gangs and turned to banditry. Today Japan has 78,000 yakuza-literally, "good for nothing"-who play a role in practically every facet of Japan's economy and society. They live by a samurai-like code of loyalty, and to show penance for breaking it they cut off their fingertips. In the past, errant yakuza favoured swords for this. Nowadays, some try to lessen the pain by using a hammer and chisel.

THE COST OF BAD DEBT

No one knows the true size of Japan's bad debts. One estimate, by U.S. investment bank Goldman Sachs, puts it at ¥237 trillion, or 39% of all corporate loans. But everyone agrees the crisis is deepening as Japan slides further into recession. Worse, many loans are collateralized with properties still valued at unrealistic "bubble economy" prices, meaning the write-offs needed will be far greater than the banks or the government admit. The only solution, believe many analysts, is a fresh injection of public money, dwarfing 1999's bailout of ¥7.5 trillion.